

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 02-0199 AGI**  
**ADJUSTED GROSS INCOME TAX**  
**FOR TAX PERIOD: 2000**

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**Issues**

**1. Adjusted Gross Income Tax: Human Services Tax Deduction**

**Authority:** IC 6-3-2-1, IC 6-3-1-3.5 (a) (14), Income Tax Information Bulletin #80, April 1997.

The taxpayer protests the disallowance of the human services tax deduction.

**2. Tax Administration: Negligence Penalty**

**Authority:** IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the negligence penalty.

**Statement of Facts**

The taxpayer filed a 2000 Indiana Income tax return, form IT-40EZ. The taxpayer, a quadriplegic, lived in a nursing home paid for by medicaid and was gainfully employed by an Indiana business during the tax period. The taxpayer had taxable wages in 2000 and had a total tax liability per his original return of \$1,285.00. The taxpayer had total credits, from withholding of state and local tax by his employer in the amount of \$1,329.00. The taxpayer requested and received a \$44.00 refund.

The taxpayer later filed an amended return for 2000 claiming all income was exempt under the human service deduction. The taxpayer was issued a refund of all taxes paid. Later, the Indiana Department of Revenue, hereinafter referred to as the "department," adjusted the return to disallow the human service deduction and billed the taxpayer for the refund issued in error, interest, and penalty. The taxpayer protested the assessment and a hearing was held.

## **1. Adjusted Gross Income Tax: Human Services Tax Deduction**

### **Discussion**

Pursuant to IC 6-3-2-1, an adjusted gross income tax is imposed upon all Indiana residents. After determining the Indiana adjusted gross income, taxpayers may take certain statutory deductions. One of these deductions is the human services tax deduction that is stated at IC 6-3-1-3.5 (a) (14) as follows:

In the case of an individual who is a recipient of assistance under IC 12-10-6-1, IC 12-10-6-2, IC 12-15-2-2, or IC 12-15-7, subtract an amount equal to that portion of the individual's gross income with respect to which the individual is not allowed under federal law to retain an amount to pay state and local income taxes.

Income Tax Information Bulletin #80, April 1997, discusses the application of the deduction. The purpose of the deduction is explained as follows:

There are instances in which persons who are receiving Medicaid may have a source of taxable income such as a pension or annuity or be entitled to a monthly personal allowance. The receipt of this income gives rise to state and local income tax liabilities. However, an individual on Medicaid is allowed to retain an amount equal to the individual's state and local income tax liabilities.

Under the terms of Income Tax Information Bulletin #80, April, 1997, a taxpayer is eligible to receive the deduction if:

1. The person receives medical assistance payments (known as Medicaid.),
2. The person does not live at home,
3. The person receives care at a hospital, a skilled nursing facility or an intermediate facility.

The department and the taxpayer agree that the taxpayer received medicaid, did not live at home, and lived in a skilled nursing facility. Therefore, the only issue to be determined is the proper computation of the deduction.

Directions for computation of the human services deduction are found in Income Tax Information Bulletin #80, April, 1997, as follows:

### Step #1

Complete the IT-40 without using the human services tax deduction. If the total Indiana Credits on Line 26 is greater than the Total Tax on Line 19, you are not eligible to claim the deduction. However, if the Total Tax on Line 19 is greater than the Total Indiana Credits on Line 26, go to Step #2.

### Step #2

Complete a second IT-40 using the human services tax deduction as computed in this step. Take Line 11, Indiana adjusted gross income figure computed in Step#1 and place the sum of Line 9 of the IT-40. This sum is the amount of the human services tax deduction to which you are entitled. This figure should also be entered on Schedule 1, Line F of the IT-40 and labeled Human Services Tax Deduction.

Since the tax form line references referred to the 1996 IT-40 tax return, the references did not correspond correctly with the 2000 IT-40 EZ tax return. The taxpayer was required, therefore, to interpret the meaning of the various lines. The taxpayer classified the taxes withheld as an Indiana credit and compared it to his total tax. The withholding was greater than his tax liability, so the taxpayer interpreted this as indicating that he qualified for the Human Services Tax Deduction and requested the refund of his total taxes paid.

The taxpayer erred in this computation. The withholding was deducted from earned income as opposed to annuity or pension income as the written purpose of the Human Services Deduction indicated was the target income. Further, the term "Indiana Credit" referred to such credits as the gifts to Indiana colleges. The taxpayer did not have any of these credits available to him. Therefore, the taxpayer's Indiana Credits did not exceed his tax liability on non earned income. The taxpayer did not qualify for the Human Services Tax Deduction.

### **Finding**

The taxpayer's protest is denied.

## **2. Tax Administration: Negligence Penalty**

### **Discussion**

The department assessed the negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

In this case, the taxpayer attempted to follow a seldom used and poorly understood deduction from the adjusted gross income tax. The taxpayer obtained and tried to follow the directions in the department's publication concerning operation of the deduction. Unfortunately, the directions referred to specific tax lines on a form for a previous tax return form and were difficult to apply to the taxpayer's 2000 form. The taxpayer used reasonable care in attempting to properly apply the deduction to his situation. Therefore, although the taxpayer erred in his application, the negligence penalty does not apply in this case.

### **Finding**

The taxpayer's protest is sustained.